No. 13523

United States
Court of Appeals
for the Ninth District

ESTATE OF WALLACE CASWELL, Deceased; JENNIE J. CASWELL, Administratrix,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

and

ESTATE OF CHARLES HENRY CASWELL, Deceased; EARL W. CASWELL, Administrator,

Petitioner,

vs.

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Reply Brief of Petitioners

ON PETITION TO REVIEW DECISIONS
of the Tax Court of the United States

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PRELIMINARY STATEMENT

The petitioners filed their brief in these petitions for review on the 16th day of February, 1953, and the brief for respondent was received by the petitioners' attorney on March 24, 1953. This Reply Brief is, therefore, due to be filed on or before April 3, 1953.

ARGUMENT

It is to be noted that the statement of facts by the respondent (his brief—pages 2-11) is that reported by the Tax Court, which your petitioners have heretofore pointed out as being inconsistent with the stipulation of facts, the only facts of record. On the following, the petitioners and the respondent apparently are in agreement:

That the crop was sold pursuant to a contract, whether with a member or non-member at the time of execution;

That title passed at time of such execution;

That upon harvesting of the crop and delivery to the Cooperative, the grower was paid partly in cash, after credits for previous advances whether as a member or not; and,

That the following year or later, the certificate, which was non-negotiable, was issued to the grower pursuant to the contract and representing his eventual claim upon or possible recovery from the Cooperative for the balance still due under the original contract.

Respondent insists that in effect, the amount shown on the certificate is a capital or equity contribution. Petitioners do not believe that respondent will deny that from the date of delivery of the crop until the issuance of the certificates, the Cooperative is obligated to the grower in one form or another, as shown on their balance sheets as "currently due growers," and that a year or more subsequent to the "purchase" of the crop, the certificate is issued in the amount of the obligation. Petitioners contend that however you label it, the certificate is in exchange or acknowledgement of that indebtedness, with the transfer of that liability to the commercial reserve account. If determined to be a capital contribution, then pursuant to Section 112(b) (5) such exchange is non-taxable to all growers receiving such certificates, whether the exchange be determined an exchange of the unpaid portion of the crop, or of the indebtedness, for the equity in the Cooperative.

The respondent (his brief—page 11) emphasizes that the "surplus retained in the Co-op's revolving fund equals the face amount of the outstanding certificates." It is rudimentary accounting that the debits must equal the credits whether those credits are shown erroneously in the equity account or in the loans payable account. The true measure of the value is not that the books balance, but that the realizable value of the assets is equal to the amount of the liabilities. It is to be noted that in the balance sheet of January 1, 1946, there are liabilities of $472,634.64 due others than growers, and $844,241.97,

exclusive of membership fees, due the growers. Ultimately, the security of this amount is dependent upon realizing full value from inventory. Contrary to respondent's statement (his brief—page 15) that the "same conditions are shown by the 1949 and 1950 balance sheets" as for January 31, 1946, the liability to growers was 64% of the total liabilities on January 31, 1946, but the indebtedness of the Cooperative to others had so increased that on January 31, 1950, the percentage of liability to the growers had dropped to 37%; conversely, on January 31, 1946 13.2 percent of the assets were represented by canned goods inventory and this percentage had increased to 68.4 percent on January 31, 1950.

That canned foodstuffs are highly speculative in value is unquestionable. Respondent admits (his brief—page 15) that there was no fund back of the certificates, and that the petitioners had no assurance they would be paid (his brief—page 14). It is stipulated that the Certificates are inferior to all obligations of the Cooperative (Sec. 5, Art. XIII, By-laws).

Respondent's reference to Rumble, Cooperatives and Income Taxes, 13 Law and Contemporary Problems (1948) (his brief—page 15) merely raised the issue now before this Court, does not attempt to answer the question raised, and is in reference to taxability of the cooperative, not the member.

The respondent states (his brief—page 16) that the "Tax Court found, based on the provisions of Section 111(b) of the Internal Revenue Code and

Section 29.22-7 of Regulations 111 . . . "Petitioners submit that nowhere in the opinion or decision does the Tax Court mention section 22 of the Internal Revenue Code or Regulations, to which section the petitioners contend the Tax Court should have addressed itself, and under which petitioners would not be taxable. In fact, the Tax Court (R-37) bluntly rejected section 22(a) on the issue of constructive receipt.

The respondent, in reference to *Brown v. Commissioner, 69 F2d 863,* (his brief—page 17) states incorrectly that the case involved co-op stock, whereas in fact it concerned "her (the taxpayer's) part of the accumulated profits of the (timber) corporation represented in the redistribution of its stock."

The respondent (his brief—page 17) refers to the Income Tax Information Release No. 2, April 13, 1950, the validity of which is here at issue.

The respondent comments upon cash basis farmers expensing their crops in the year of growth, and that "any proceeds from a sale, whether in cash or property, constitute income . . . ", (his brief—page 17). This is true of any cash basis taxpayer. But, here, what did the farmer receive for that year's crop other than cash and an obligation (not the Certificate) from the Co-op for the balance?

Respondent takes issue with petitioners in their reference to I. T. 3342, 1940-1 CB58 (his brief—page 13), on the ground that it concerned notes for interest payments. The official heading of the I.T. 3342, is "Ownership certificates for bond interest",

(underscoring supplied) and is authority for the holding that such certificates were not taxable until redeemed.

It is to be noted that all the cases cited by the respondent concern the sale or exchange of capital assets and not the sale of crops, inventory, or stock-in-trade. It is further noteworthy that the respondent attempts to justify the Tax Court opinion and decision on the basis of Section 22, Internal Revenue Code, although the Tax Court assiduously avoided reference to such Section. The reason is simple, because the Tax Court's reliance on Section 111(b) was improper, and only by applying the rules of that Section to Section 22 of the Internal Revenue Code could the decision be justified. But, the petitioners could not have been taxed during the year of issue of the certificates under Section 22 because there was no actual or constructive receipt, the equivalent of cash, or the accrual basis. The very keystone of income tax law is that income is taxable when accrued or realized, and to be realized the decisions have consistently required reduction to possession, control, or command as set forth in Section 29.42-2, Regulations 111.

Petitioners reiterate that the theory of taxation here advanced by the Commissioner and approved by the Tax Court would completely subvert the intent of Congress in its relief provisions for Cooperatives, Section 101(12), Internal Revenue Code, by turning a Cooperative into a partnership. While we are not

concerned with what Congress might have done, we can hardly ascribe futility to their actions.

CONCLUSION

Inasmuch as the only facts of record were stipulated, petitioners submit that this Court is not bound by the erroneous findings of fact by the Tax Court. Actually, the issue is whether this Court will approve an administrative rule, Income Tax Information Release No. 2, supra, in contravention of generally accepted principles of taxable income, with a conclusive inference that certificates issued in pursuance thereof, are taxable upon issuance at their face amount. Petitioners respectfully submit that such a ruling thwarts the intent of Congress, and is contrary to our heretofore accepted concepts of taxable income set forth by statute, regulations and court decisions.

The decision of the Tax Court should be reversed on their erroneous findings of fact, in reference both to the realization of income by the petitioners at the time of issuance of the certificates, and as to the fair market value of those certificates, if their issuance is deemed to result in taxable income.

Respectfully,

WAREHAM C. SEAMAN,
Attorney for Petitioners.